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C O N F I D E N T I A L SECTION 01 OF 03 BAKU 000282

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SUBJECT: DAS BRYZA DISCUSSES ENERGY COOPERATION WITH FM  
MAMMADYAROV, MED BABAYEV, AND DEPUTY SPEAKER ALASGAROV

REF: BAKU 136

Classified By: AMBASSADOR ANNE E. DERSE PER 1.4(B,D).

11. (C) SUMMARY: During a March 4-5 visit to Baku, EUR/DAS Bryza discussed energy cooperation in separate meetings with Foreign Minister Elmar Mammadyarov, Minister of Economic Development Heydar Babayev, and Deputy Speaker of Parliament Valeh Alasgarov. Bryza briefed Mammadyarov on his recent energy talks with the Hungarians, cautioning that Azerbaijan's hesitance to sign a deal was making the Europeans nervous, especially while Gazprom was leading them to believe that Azerbaijan did not have sufficient gas to fill the Nabucco pipeline. Alasgarov complained of Russia's backdoor tactics in courting European countries to join Southstream, and recommended that the U.S. stop pressing them to act in their own interests and let them drift a bit. Echoing Alasgarov's reference to "Turkish arrogance," Babayev said that Azerbaijan's priority was to sell gas to Europe, not just Turkey. He agreed with DAS Bryza that political leadership was needed in the negotiations, noting that if price were really the cause of the disputes, they would have been resolved by now. END SUMMARY

FOREIGN MINISTER  
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12. (C) During a March 4 meeting with Foreign Minister (FM) Mammadyarov, DAS Bryza briefed on his recent discussions with the Hungarian government regarding Hungary's March 6 decision to join Russia's Southstream gas pipeline. He said that it was critical for Hungary to establish diversification before moving on to an agreement with Russia, but noted that Hungary -- like Bulgaria -- was under tremendous pressure from Russia, and making political, rather than strategic, decisions. DAS Bryza emphasized that the USG believes there will be sufficient demand for natural gas to sustain both the Nabucco and Southstream pipelines. However, he said that Southstream was designed to derail Nabucco and the Turkey-Greece-Italy (TGI) pipelines and prevent Azerbaijani gas from reaching Europe. Southstream faced a serious economic disadvantage in comparison with TGI and Nabucco, but may end up being built but remain half empty, as has been the case with the Blue Stream pipeline linking Russia and Turkey; Gazprom could finance Southstream within three years by simply raising the price of gas in Europe.

13. (C) Bryza told the FM that the USG is working with Hungary to encourage it to remain aligned with its Nabucco partners to secure diversification of gas supply, rather than being diverted by Southstream. He said that Hungary's MOL had expressed willingness to sign a gas sales/purchase agreement with Azerbaijan -- today -- but Azerbaijan was not ready because of its gas transit dispute with Turkey. According to Bryza, both Turkey's BOTAS and Azerbaijan's State Oil Company (SOCAR) embrace models of gas transit pricing that are in use in Europe, and are therefore unwilling to compromise.

Resolving this dispute requires its elevation to the political level for discussions between President Aliyev and Prime Minister Erdogan. A possible solution, Bryza continued, was for Turkey to reach a straightforward gas sales/purchase agreement with Azerbaijan for a set volume of gas (rather than a 15 percent reserve of the gas flowing across Turkey) at a price lower than the Russian price in Turkey that Azerbaijan favors but higher than the "netback" price enshrined in TGI's inter-governmental agreement. Bryza cautioned that failure to wrap up the gas transit dispute was providing space for Russia to court Central and Southern European countries for Southstream rather than TGI and Nabucco.

14. (C) Bryza noted that the U.S. had been urging Turkey to behave as a reliable transit state rather than as a broker of gas sales, adding that Turkey was most worried about having sufficient gas for domestic consumption at a politically palatable price - e.g., not more expensive than Azerbaijani gas sold further downstream in Europe. Mammadyarov stated that while oil is Azerbaijan's "cash cow," the GOAJ was "doing gas for political reasons." This, he said, was infuriating Russia and Iran, but the GOAJ persisted because it was important for Azerbaijan's future. The FM said that the GOAJ was tired of "talk and lip service" from the Europeans, and that he thought the GOAJ would continue negotiating with Turkey. Mammadyarov agreed the solution would have to be mutually beneficial to Turkey and Azerbaijan. But if such a solution were reached, he asked, would the Europeans be ready? DAS Bryza assured the FM that they were, and were indeed anxious to move on with gas sales/purchase agreements, specifically listing Greece, Romania, Hungary, and Bulgaria; he emphasized that Gazprom had led them to believe Azerbaijan did not have sufficient

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gas.

DEPUTY SPEAKER OF PARLIAMENT

15. (C) DAS Bryza discussed energy policy, including political and contractual roadblocks, with Deputy Speaker of Parliament and former SOCAR official Valeh Alasgarov. After briefing Alasgarov about the negotiations, Bryza said the two big challenges to the current negotiations are the Europeans' disbelief that Azerbaijan has enough gas to supply the potential pipelines; and Turkey's desperation to obtain cheap gas for its estimated future needs.

16. (C) Alasgarov said that many European officials discussing Nabucco or TGI are doing so in bad faith and are "in Gazprom's pocket," recalling that Gazprom provided over \$150 million to Turkish officials to secure Turkey's agreement to pursue the Blue Stream pipeline in the late 1990s. He pointed out that Azerbaijan has offered "100 percent ship-or-pay" contracts as a guarantee that it will provide the amount of gas promised or pay for it. Alasgarov asserted that this eliminates the risk of volume shortages or price fluctuations for European countries and makes it impossible to blame European reluctance on economic or logical reasons. He also spoke disparagingly about Austrian gas company OMV, saying it wants an agreement with large volumes for financing and then plans to use Azerbaijani gas for its own speculative gains. Azerbaijan should sign a contract to guarantee the price it would receive rather than let OMV "use our volumes for their financing," retain 51 percent ownership, and reduce payments to Azerbaijan with a list of reasons like the high cost of operations and financing or low rates-of-return, Alasgarov added.

17. (C) Alasgarov pointed out that according to Turkish law, BOTAS is required bid out 80 percent of contracts to private companies. The law also gives the seller the final right of refusal, Alasgarov said, in theory making it possible for Gazprom to designate the private gas companies it will

contract with in Turkey by refusing seller approval to any company but the one Russia chooses. Annoyed about "Turkish arrogance" and suspect of the motives behind the Turkish 15 percent netback proposal, Alasgarov said, "Azerbaijan cannot be dictated to." He said that Azerbaijan could sell its gas at a good price "right here," alluding to the potential for a bigger profit from selling gas to Iran than shipping it to Europe. He thanked the U.S. for its efforts to maintain the Nabucco and TGI countries' focus on these two projects, despite the fact that it would not be a direct beneficiary, but pointed out that, "you don't have to save them," alluding to Europe. Alasgarov recommended that the USG stop negotiating with European countries. Alasgarov said he was pessimistic about Europe and Turkey's political will to move forward on Nabucco or TGI given the Russian influence. He said that while prime ministers and presidents would change, attitudes would remain the same.

MINISTER OF ECONOMIC DEVELOPMENT  
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18. (C) Minister of Economic Development Heydar Babayev discussed economic growth, the upcoming Economic Partnership Commission (EPC), co-financing, and energy with Bryza. Babayev said that over the next two years Azerbaijan will have more than 15 billion USD in oil revenue, and the GOAJ knows it must control budget expenditures closely to prevent runaway inflation. He pointed out that Azerbaijan's accession to the World Trade Organization (WTO) was still "at the top of the agenda" and thanked the U.S. for the good bilateral relationship it has maintained with Azerbaijan in every sphere.

19. (C) Babayev said he hopes to attend the EPC on April 14-15 to highlight "the positive results of our joint efforts." Bryza agreed but raised the issue of co-financing of U.S. assistance programs, which the Ambassador pointed out is an important part of the bilateral relationship and key to EPC success. The Ambassador asked for clarification of a recently-received letter outlining a new bureaucratic process for co-financing approval to comply with Azerbaijani law. The Ambassador pointed out that the new process will send the wrong signal if it is applied to previously discussed co-financing projects. Babayev reassured Bryza and the Ambassador that the GOAJ has set aside 1.7 million AZN (other sources have said 1.6 million AZN - approximately 1.9 million USD) to co-finance joint projects. However, he said, Azerbaijani law prohibits money transfer to a U.S. Treasury account. Babayev said he would speak to Minister of Finance Sharifov, but reassured the Ambassador and Bryza that the letter will not slow down co-financing of previously

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discussed projects. Instead, he said, it is just a question of finding the right mechanism to allocate the money.

110. (C) Babayev characterized energy discussions with Greece, Turkey and Italy as positive, but then began to talk about a possible Trans-Adriatic Pipeline to Switzerland. Babayev said, "The more countries (in Europe) that we supply with oil and gas, the bigger the attraction will be for Central Asia," which he described as still "hesitant." DAS Bryza urged Azerbaijan to focus on achieving TGI and Nabucco as priorities, citing the urgent need for gas supply contracts for TGI soon and making sure it has the gas to fulfill its obligations on time. Bryza briefed Babayev on his recent discussions in Turkey and Europe. To move TGI negotiations forward, Bryza said that he is encouraging Turkey, and now asking Azerbaijan, to raise negotiations on gas transit to the political level. Babayev agreed that political leadership is necessary, saying that if price was really the issue slowing the negotiations down, it could have been resolved in a week. To prevent a relationship from becoming problematic, like the one between Russia and Ukraine, Babayev said the contracts should be clear. Turkey should know how much gas it wants and how much it is willing to pay.

Azerbaijan, he said, should know how much it can export and should be able to fully fulfill its contract. Azerbaijan is ready to do its part, Babayev said, but BOTAS' behavior is manipulative, resembles Gazprom's, and creates misunderstandings. Babayev said Azerbaijan wants to do more than supply Turkey with gas; it wants to supply gas to Europe. He agreed with Bryza that reaching a political compromise with Turkey that involves direct gas sales/purchase agreements between Turkish and European consumers and Azerbaijan's SOCAR is necessary.

COMMENT

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¶11. (C) The standoff with Turkey over the 15 percent netback proposal clearly continues to rankle senior GOAJ officials. SOCAR has indicated that the issue could be resolved in April, after Azerbaijan and Turkey agree to a new price of Shah Deniz Phase I gas (reftel). The proposed U.S.-Azerbaijan-Turkey trilateral meeting on the margins of the Economic Partnership Commission, coupled with EU Nabucco Envoy Van Aartsen's efforts, could help make progress on this issue.

¶12. (U) DAS Bryza has cleared this message.  
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